BUDGET COMMITTEE

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Senator Gregg's Senate Floor Remarks on Proposed Economic Stimulus Package
(unofficial transcript)

I wanted to address the economic slowdown. It is important to put this in some sort of context. It is important to know how significant it is.

We had economists today testifying before the Budget Committee, where I'm the ranking member, where they said that we were going into recession. We have economists who feel we are headed into recession who are highly respected. I saw Mr. Feldstein express that. Professor Blinder of Princeton, who was a Federal Reserve member at one time, expressed the view that he didn't know.

Some things are fairly clear. The first is there is tremendous stress on the economy because of the sub-prime meltdown in the housing market and, in fact, the numbers are fairly staggering that the housing situation is about as severe as it has been in recent history.

And that has led to a contraction of credit generally, which is what happens, regrettably, in a situation like this, where you have a very significant sector of the economy which has been subject to a bubble situation where there was an expansion which was not supported by the underlying value and which cannot, in this case, be supported by the repayment structure that's in place or the value of the collateral. The bubble bursts and people find themselves unable to repay their loans and the value of their collateral isn't high enough to offset the value of the underlying loan, and, as a result, that credit is contracted and that leads to other credit being contracted.

As those loans, unfortunately, dry up and go bad or can't be repaid, you find that the banking community, generally, has to continue to maintain its capital and liquidity position and it starts to contract and stops lending to people who can repay and who are good risks because the bank community doesn't have the resources to continue to expand, because it's being contracted by the reduction in the value of the portfolio tied to housing. This feeds on itself.

Regrettably, I have been through this three times in my professional career and the worst was when I was Governor of New Hampshire. At that point in the late 1980's, early 1990's, we had a national crisis relating to housing, which translated into a crisis in banking and, in fact, of the seven major banks in New Hampshire, all were statistically insolvent, five of them failed. Two of them survived because they were owned by outside banks which had the resources and the capital to prop them up.

But that was a regional event and due to a lot of factors, primarily explosive lending in the 1980's which was again from the exploding collateral, and those who couldn't repay their loans now that they couldn't roll the loans over because the banks were not able to give them additional funds because they didn't have it.

This time it appears to be a little different. So much of this housing paper has been sold and resold and is spread, literally, across the world. You could have gotten a mortgage in New Hampshire and have somebody in Germany own it now or some part of it as a result of the resale.

So the risk has been spread outside the American banking system, but that has two effects. One, it does spread the risk, but the second problem is as the sub-prime loans come up…for people who have good jobs and can pay a reasonable rate, these ARMs are coming up at such high rates that they aren't reasonable, and those folks are finding it difficult to renegotiate because there's nobody at the teller window, so to say. They're dealing with servicing agencies which have no relationship to the people who hold the debt. So it is very hard to renegotiate these loans effectively.

And this all is compounding on itself. It looks like it is going to lead to a fairly significant slowdown and has been said by a number of people, a recession. The Fed has cut rates twice, once by 75 basis points and again at 50 basis points. Those are significant cuts and should have a positive impact on the formation of liquidity in the market and also on taking the pressure off of the refinancing effort in the area of lending.

But it takes six to nine months when the Fed cuts its rates before that works its way through the system. So the question is, what do we do to stimulate the economy now, today, in the next six months to nine months when the slowdown is difficult to deal with because of the housing market crisis compounding into the general lending area crisis.
The fact that some of our major banking institutions are under very significant stress.

Well, my view is, I guess it's a minority view, that you focus the effort on things which are going to give you not only immediate stimulus, but, hopefully, in the long term a stronger economy. In the long term, an economy that is more efficient and more effective in creating jobs and making the American economy stronger.

And so you value every one of the options that are on the table by the basis of, does it give you stimulus in the short run, but also, does it give you something in the long run that will produce a stronger economy. The proposals that are on the table are mostly divided into two categories, one is to give people money to spend and, two, is to give businesses incentives to go out and buy equipment and invest.

The money-to-spend issue becomes fairly problematic in a world economy. You give somebody $500 or $600 to spend and if they actually spend it and they don't spend it on goods that are produced in the United States, it has virtually no impact on stimulating our economy. If you purchase a television in Vietnam with the $500 you received as a tax stimulus, well, that has nothing to do with creating jobs in the United States. It may create jobs in China, it may create jobs in Vietnam, but it doesn't create jobs here except for the resale effort in the United States.

Also, if you give the high-income individuals a tax rebate, historically, those dollars don't get spent at all. They don’t stimulate the economy in that sense at all. They get saved because high-income individuals have the discretionary income to spend anyway. If they get a windfall of $500, $600, $1,000, they're not going to spend that in addition to the money they already have. They're not going to spend it, they're going to save it and it does nothing to stimulate the economy.

When we look at this tax rebate effort, the classic effort of creating demand in the economy in the slowdown period, you have to look at what are the practical implications, what are the real implications of putting money on the table for the people to begin with. It makes no sense at all to give it to high-income individuals.

I don't understand the Finance Committee draft, if secondly, unless this money can get out fairly quickly and unless you can be fairly confident that it is going to go to purchases which are going to assist the American economy, then probably all you're really doing by sending this money out the door in the form of a tax rebate is creating an income transfer, which will obviously benefit lower income people from a social standpoint, but probably won't have much of an impact on the economic policies of a stimulus.

And it doesn't look like we can get this money out the door very fast. The fastest track I've heard was justified by the CBO director who said the IRS could get these checks out maybe by the middle of June. But he also said that the practical implications are that those dollars will not have an impact on the economy until the end of the third quarter, beginning of the fourth quarter, or as he said, the Christmas season of this year. By that time, the Fed rate cuts will probably also have kicked in and started having an impact, so you may not be getting what you want, which is action in these first six months of this year versus action at the end of this year to stimulate the economy.

And in fact, you may have two stimulus events coming in on top of each other, which might actually be inflationary. It would seem to me that rather than taking this approach, it would make a lot more sense to put money where the problem is.

Now, this has been resisted by the Administration, and it's not being talked about a lot around here by the folks who are putting in the other package. But it would seem to me that middle-income people who have these sub-prime loans that are rolling over are the people who really need the ability to refinance those loans so they don't get foreclosed on over the next six months.

And there are a number of ways we can do that. There are a number of ways we could actually put money into that area as a federal government and which would benefit that group of people who appear to be at the essence of the problem, more than just setting the money out to everybody and hoping their demand will raise the economy generally.

A tax credit to those folks, which is refundable based off of their interest payment on the refunded loan is one option to get them through this period. A restructuring mechanism which allows them to restructure and get assistance through restructuring by significantly expanding FHA, by raising and putting that in the package, which it is not in the package. It is being talked about on a separate vehicle, but it is not in the package. That would help.

Giving state housing authorities more capacity to put money into the market would help. And that is being talked about, which is good.

Allowing Freddie Mac and Fannie Mae to raise their cap, but to do it in the context of also underlying reform so that we don't end up a year or two from now with Freddie Mac and Fannie Mae that are going under; that would help. The first part is being talked about, raising the cap, but not the second part, the reform mechanism.

So there are things we could do that I think would get to the problem more appropriately and hopefully mute the issue of the economic slowdown and would also in the long run create a stronger economy, a much stronger economy.

I'm a primary co-sponsor of legislation that Senator Isakson introduced today to do this in the area of tax credits, but it's not going to be included in the package, which is unfortunate.*

The second part of the package which is being talked about is investment incentives for businesses, small businesses. They should be directed at small business, by the way, because small business creates jobs in this country. These involve expensing and bonus depreciation, as referred to, and net loss operating carry-back, so if you've got a net loss this year because we have a slowdown, you can apply it to years you have a profit, reducing your tax burden.

These are all good ideas, in my opinion, very good ideas, and will strengthen the economy in the long run, will make us more efficient and create more jobs. Jobs are the bottom line. So I have no problem with that part of the package.

The third part of the package being talked about is extending unemployment insurance. If you talk to most of your economists around here that present before the Congress and many of them do obviously, before the Budget Committee, we have an almost un-ending stream of economists presented to us who come out of the school which I would call the Galbraith School of Economics, which is sort of the Harvard School of Economics, which is a stepchild of the Keynesian school of economics of the 1930's. They will basically say if you want to get dollars into the economy quickly, you put it in through unemployment insurance and food stamps because that gives you an immediate boost in the economy to people who will spend it because they need it. That's probably a legitimate argument, especially on food stamps. But on unemployment insurance, it is not a legitimate argument if you have full employment.

In fact, it's the absolute opposite of what happens when you have full employment to extend the unemployment insurance benefits by a year, which is what's being proposed. In areas that have essentially full employment, it means you give a disincentive to people to go out and find a job in an atmosphere where jobs exist.

By definition, if you have a full-employment economy, you've got jobs going unfilled.
So, for example, in my state of New Hampshire where we have an unemployment rate which is essentially 3.7%, 3.8% for the state, the highest level of unemployment that we have in any county in New Hampshire is 4.4%, we have what's known as full employment. There are pockets of problems. We have one specific town in the state which is a single-factory town and the factory has regrettably recently closed. So that specific group of individuals has a serious personal issue and there is a way to address that in a targeted way.

But to extend unemployment insurance for our entire state when we're actually below full employment? We've got a lot of jobs going unfilled when you're at 3.7% employment, full employment being 5% in our economy, in the 5% range. You essentially create an incentive for people to stay on unemployment much longer than is necessary for them to find a job.

We know statistically that if you have an economy where jobs are available, an economy where unemployment is under 5.5%, that means you have jobs available and most people find a job in the last two weeks of their unemployment. That's human nature. They stay on unemployment almost until the end and then they find a job. If you extend it another year, those folks who could be productive, producing a job, creating economic activity by having a job will stay on unemployment even though there may be a job out there that they could take because you've got jobs available.

So it makes no logic to extend unemployment insurance in areas where you have full employment. And full employment in our economy is basically under 5.5%. And the nation is at 5% right now. We have never extended unemployment insurance in this country when we've had an employment rate under 5.7%. Never. So to do this at this time is really counterintuitive to how you make the economy more efficient and as a result stimulate the economy.

One of the economists who testified before the Budget Committee today said if this would work, you should always extend unemployment insurance and keep everybody on unemployment forever, because basically if you've got a full employment economy and the economy will be more stimulated by having people stay on unemployment, just leave everybody on unemployment.

Obviously that doesn't make any sense. You're saying that with tongue in cheek. But the logic of it is, it's like saying that if you have an economy where you have jobs that aren't being filled, you don't arbitrarily extend unemployment insurance for a uniquely long period because those jobs will never be filled because nobody will ever leave unemployment insurance. It is sort of the old approach to do it that way. Not the new, but the old approach.

Yes, there may be regions of our country that have an unemployment rate where there are clearly no jobs available. Those regions need relief. And I would be more than happy to see an unemployment insurance extension which was tied to a trigger that said, all right, historically we have viewed under 5.5% as full employment. At over 5.5%, you're getting into a serious issue.

Let's take the 5.7% rate, which we have historically never gone below to extend uninsurance. But let's take the 5.7% rate, put a trigger into the system so that if a state or even a region within a state, a definable region, has unemployment of over 5.7%, they get the extended unemployment benefits. That makes sense. But a general national extension of unemployment insurance just for the sake of stimulating the economy is going to be counterproductive if you have a full employment economy in the region.

States like Michigan may need the extension. States like New Hampshire, I'm sure, on individual, anecdotal situations may need it, but as a practical matter it may be counterproductive to our economy to do it because we're at 3.7% unemployment.

So that proposal, which the House looked at and said didn't make sense in the context of this economic situation, should not be inserted by the Senate. I think the best approach we can take here -- because I obviously have reservations about the stimulus package that came out of the House on the demand side, and I have reservations about some of the initiatives within that package, and I'd like to see that package obviously include more of a target on the problem, which is address the issue of homeownership and the housing stocks which are so overpriced now and, unfortunately, empty, making sure that we figure out some way to move people towards using that to absorb that housing stock.

I'd like to see more of that, but that's not going to happen. It's not going to happen in the period of the context that we have to act. There is an agreement that exists between the President of the United States and the Speaker of the House of Representatives and the Republican Leader of the House of Representatives. And it was an agreement that involved trade-offs. But the basic underlying purpose of the agreement was, and is, to stimulate the economy.

It may or may not do that, but the one positive effect I will stipulate to that it will have is that it will create at least a sense that the Congress and the government and the President and the Speaker of the House and the Democrats and the Republicans can cooperate to try to address what is clearly a slowing of our economy through some fiscal policy action.

And it's $150 billion, which is a lot of money that is going to have to be borrowed from our children, unfortunately. And over ten years it totals up to being about a $200 billion event because of interest compounding on it. Even though that is a high price tag to pay for what you might call a confidence builder, it's still something that you can argue should be done if you've got that type of an agreement.

And for the Senate to sort of step in and say, well, we want to tinker with it here and we want to change it there, well, it's really nothing more than an execution of Senate prerogative. But it's not going to help the policy because none of the proposals coming out of the Senate committee are all that good on the side of policy, especially the unemployment proposal and the lifting of the caps on the benefits proposal. But what it is going to do is undermine the confidence of the American people that we as a government can act.

So, the high water mark appears to me to have been reached, to take sort of a mature attitude and say, well, progress was made. We're confronting a fairly serious situation. Let's not throw out our proposal simply for the sake of putting a proposal on the table. Let's recognize something needs to be done quickly and that this is the best we're going to get. Hopefully, that will be the resolution of this process as we move toward concluding, and one hopes this can be done within the next week.

I yield the floor.

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